

*United States Court of Appeals
for the Second Circuit*



**APPELLANT'S
BRIEF**

ORIGINAL

75-7483

United States Court of Appeals

For the Second Circuit.

WALLACE CLARK & CO., INC.

Plaintiff-Appellant.

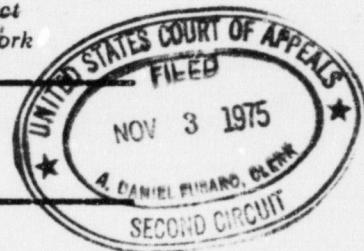
v.

ACHESON INDUSTRIES, INC.,

Defendant-Appellee.

*On Appeal From The United States District
Court For The Southern District of New York*

Appellant's Brief



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INTRODUCTION

This is an appeal by Plaintiff-Appellant, Wallace Clark & Co., Inc., (Wallace Clark) from the Judgment and Order (A 60) of Honorable Edward Weinfeld dismissing the third count (A 4) of Plaintiff's declaratory judgment complaint alleging patent invalidity. Judge Weinfeld, treating Wallace Clark's motion (A 33) to determine its right to allege invalidity as one for summary judgment, had ruled that Wallace Clark, as a matter of law, was precluded from alleging invalidity as a defense to a contract claim for royalties because of the res judicata effect of a prior consent judgment. Judge Weinfeld's two opinions are reported 394 F. Supp. 393, 186 U.S.P.Q. 138 (A 39) and at ____ F. Supp. ____, 187 U.S.P.Q. 57 (A 51).

In the Judgment and Order entered, Judge Weinfeld certified that there was no reason for delay in the entry of Judgment and formally directed the entry of Judgment under Rule 54(b), FRCP, dismissing the third count. (A 60).

Notice of Appeal was timely filed. (A 62).

History of Proceedings

This action is the third action between Wallace Clark and Acheson involving issues of validity and infringement of Acheson's Patent No. 2,976,257. The first action was instituted by Wallace Clark in December of 1971 for declaratory judgment of invalidity of Acheson's patent and its noninfringement by Wallace Clark's manufacture and sale of its product Meta-Tef 530 and other products.

That action was settled by the parties entering into a license agreement (A 7), in which Acheson required Wallace Clark to enter into a consent decree.

Paragraph 17 of this agreement reads (A 12):

"Promptly following the execution of this agreement the LICENSEE and LICENSOR agree to secure the dismissal of Civil Action No. 71-5655 in the United States District Court for the Southern District of New York in accordance with the terms of the attached Appendix A dismissal document."

The subject decree (A 15) was submitted to and was routinely signed by Judge Cannella. The decree provided that the patent was valid and infringed by only one product, the "530" compound, and expressly stated that the "decree may not be cited as an adjudication of contested issues." (A 15, par. 3).

The license agreement required a minimum royalty of \$7,500 per year (A 9) and was noncancelable (A 12, par. 16). No know-how was involved (A 13, par. 18) and the license agreement is to be construed under Michigan law (A 13, par. 19).

Wallace Clark made all the royalty payments required for the years 1972 and 1973 and then discontinued to make the specific Meta-Tef 530 product (the only product involved in the consent decree). On January 1, 1974 Wallace Clark discontinued paying the minimum royalty. No running royalties are due or in issue here since Wallace Clark contends the products it now makes are non-infringing and Judge Weinfeld expressly stated that Wallace Clark has the right to raise the issue of non-infringement as to products other than the "530" (394 F.Supp. at 402) (A48); A52-53).

In April of 1974, Acheson filed an action in the Michigan State Circuit Court against Wallace Clark for royalties due (A17) and Wallace Clark counterclaimed for declaratory judgment that it had the right to contest validity and allege invalidity and noninfringement as a denial to Acheson's claim for royalty. Since January, 1974, Wallace Clark was in the position of being required to pay a minimum royalty for sales of products outside of the decree and the patent.

In June of 1974, Wallace Clark brought this in the court below for declaratory judgment alleging the same claims as the defenses and counterclaims in the Michigan action. (A 1)

With suits pending in both Michigan and in the court below involving the same issues, Wallace Clark moved in the Michigan court for a stay, and alternatively for summary judgment as to its right to allege invalidity and noninfringement as defenses to the contract claim for royalties. (A 63-64). Simultaneously, Acheson moved for a stay in this court and Wallace Clark cross moved, for a determination of its right to allege invalidity and noninfringement as defenses to the claim for royalties.

While the motion was pending before Judge Weinfeld, the Michigan Circuit Court, Hon. Blair Moody, Jr., denied Wallace Clark's motion for stay, but ruled in favor of Wallace Clark as to the merits in an opinion dated October 3, 1974 and in an opinion on reconsideration dated November 29, 1974 (A63) (reported 184 USPQ 497). Judge Moody's decisions are premised primarily on the impact of Lear v.

Adkins, 395 U.S. 653 and secondarily on the ground that the consent decree was specifically worded to preclude using it as an adjudication of contested issues and construed it as nothing more than an order granting a stipulated dismissal (A 64).

Acheson requested leave to appeal which Judge Moody granted (A 66), but then Acheson decided to withdraw both its motion to stay before Judge Weinfeld (A 37) and its motion for leave to appeal before Judge Moody and to pursue the litigation in the court below. Wallace Clark was also willing to adjudicate the issues in the Southern District.*

Wallace Clark then stipulated to a dismissal of the Michigan action without prejudice (A 67). Judge Weinfeld, being informed of the dismissal, then proceeded to rule on the merits and rendered his opinion April 28, 1975 (A 39). Wallace Clark then moved for reconsideration and for leave to appeal, particularly on the issue as to whether the res judicata holding operated as a bar to any defense to the claim for minimum royalties in a contract suit. Judge Weinfeld's second opinion of July 21, 1975 (A 51), limited Wallace Clark's right to appeal only to the dismissal of the third count of the complaint invoking Rule 54, FRCP, (A 53) thus presenting the issue to this Court as one primarily of law.

* Wallace Clark is a small company having offices in New York City and nearby New Jersey. Its counsel's office is in New York City. Wallace Clark thought that it was desirable to proceed in the Southern District in New York because it was more economical, had experienced judges in patent matters, and further because of its liberal rules of discovery which facilitate the proof of the defenses relating to patent invalidity.

Reconsideration was denied and Judge Weinfeld further dismissed Archeson's cause of action alleging contempt, since the decree contained no injunctive provision (A 54).

It is implicit in these opinions that Wallace Clark has no defense to the contract requiring minimum royalties for the life of the patent, although Wallace Clark may not be infringing the patented invention or violating any provision of a consent decree.

STATEMENT OF THE QUESTIONS PRESENTED

1. Where a patent license requires the entry of a consent judgment adjudicating validity and one product as infringing, is the question as to whether validity may be raised as a defense to a claim for royalty payment governed by state or federal law?

2. May a licensee raise validity as a defense to a claim for royalty payment where a consent judgment had been entered adjudicating validity?
 - a) Has there been an adjudication of validity where the decree expressly states that it may not be cited as an adjudication of contested issues?

POINT I

THE LEAR RULE SHOULD
APPLY TO THIS
CONTRACT DISPUTE

In Lear v. Adkins, 395 U.S. 653 (1969) the Supreme Court held that a licensee may challenge patent validity as a defense to royalty payments notwithstanding binding contract principles. The purpose of this holding was not merely to put aside a dubious doctrine of licensee estoppel, but to give force to the public interest policy which limits monopolies only for inventions which meet the strict standards set forth in the Constitution and Congress. The Court gave licensees as a class standing to challenge validity since licensees would be the one group having an economic interest in raising the issue of royalty. In Blonder-Tongue Laboratories v. University of Illinois Foundation, 402 U.S. 313, 346, (1971) the Supreme Court interpreting Lear, said:

"Lear permits an accused infringer to accept a license, pay royalties for a time, and cease paying when financially able to litigate, secure in the knowledge that invalidity may be urged when the patentee licensor sues for unpaid royalties."

Judge Weinfeld's opinion refused to extend the principles of Lear to a license agreement where a prior consent judgment was issued holding the judgment to be res judicata; and he denied Wallace Clark the right to raise invalidity as a defense to a claim for royalties based on a contract which required the entry of consent judgment.

His holding, we submit, is inconsistent and directly in conflict with the decisions of the 7th Circuit, Kraly v. The National Distillers and Chemical Corporation, 502 F. 2d 1366

(7 Cir. 1974) (consent decree and settlement agreement); Crane Aeroquip Corp., 504 F. 2d 1086, 1092 (7 Cir. 1974); USM Corp. v. Standard Pressed Steel Co., 184 USPQ 476 (N.D. ILL. 1974) (consent decree), as well as being in direct conflict with the Michigan Circuit Court in Acheson Industries, Inc. v. Wallace Clark & Company, Inc., 184 USPQ 497 (A63). It is further inconsistent with the lower court Kraly decision, Kraly v. National Distillers and Chemical Corp., 319 F. Supp. 1349 (N.D. Ill. 1970) (Will, J.) which was referred to approvingly by the Supreme Court in Blonder 402 US at 345, f.n. 43, and with Massillon-Cleveland-Akron Sign Co. v. Golden State Adv't Co., 444 F. 2d 425 (9 Cir.) Cert. denied, 402 U.S. 873 (1971); Rialto Products Inc. v. Rayex Corp., NYS 2d __, 166 USPQ 222 (settlement agreement). See also Brose v. Sears, Roebuck and Company, 455 F. 2d 763, 767-768, f.n. 7, (5 Cir. 1972), (also referring to Kraly approvingly). These cases held the public interest to be primary and pervasive.

Schlegel Mfg. Company v. USM Corp., __ F. 2d __ (6 Cir. 1975) (Appeal No. 74-2256, decided September 25, 1975), and Broadview Chemical Corp. v. Loctite Corp., 474 F. 2d 1391, 1995 (2d Cir. 1973) involved contempt actions and considered the issue here. Schlegel expressly disagreed with Kraly putting the Sixth Circuit at odds with the Seventh and simply elected one policy over the other.

Broadview did not decide the issue. Broadview involved a contempt action originating well before Lear. The trial court after an evidentiary hearing, adjudicated infringement and therefore contempt. Invalidity was not raised as a defense in the trial court. On appeal, it was raised for the first time and was quickly dismissed.

Broadview is at least different because invalidity was not raised in a case adjudicated on its merits during trial. Broadview began in 1964 and was before this Court three times and this Court decided to put the issue to rest after nine years of litigation. The issue presented then is whether the consent decree bars Wallace Clark from raising the Lear invalidity defense to the license agreement. This issue has not been resolved in this circuit.

State Law Should Govern
On a Contract Question

Contempt is a different proceeding than a suit on a contract for royalties. In the present case, Acheson could cancel the license agreement exposing Wallace Clark to the decree. However, Acheson preferred to maintain the suit as one of contract.

The issue as to the right to raise a contract defense is a contract issue; state law should govern although there exists a question as to patent validity. American Harley Corp. v. Irvin Industries, Inc., 27 N.Y. 2d 168 (N.Y. Ct. App. 1970), 167 USPQ 553; Research Frontiers Inc. v. Marks Polarized Corp., 290 F. Supp. 725 (E.D.N.Y. 1968), 169 USPQ 547; Wade v. Lauder, 165 U.S. 624 (1897). And since the agreement provides that Michigan law governs (A13), the decision of the Michigan Circuit Court is entitled to great weight, if not being decisive as to whether a contract defense may be raised. The decree in issue here specifically recites that it may not be cited as an adjudication of contested issues. It

expressly omitted the requirement against using or citing the decree, "against third parties" only upon which P.C.R. Golf Ball Co., Inc. v. Chemold Corp., 361 F. Supp. 187 (E.D.N.Y. 1973) rests. This was one basis of the Michigan Court's decision: 184 USPQ at 498-499 and 499-500 (A 64-65, 65-66).

The only New York state case discussing settlement agreements and dismissal of federal patent actions, Rialto Products, Inc. v. Rayex, Corp., ___ NYS 2d ___, 166 USPQ 222, expresses public policy consistent with Judge Moody's opinions.

Inasmuch as the highest state courts of Michigan and New York state have not ruled dispositively of the issue, we will discuss the issue on its merits although we submit, that until such highest court has ruled or overruled state law is what the lower court says it is.

POINT II

RES JUDICATA DOES NOT
REQUIRE CONSENT DECREE ESTOPPEL

We recognize that a consent judgment is more than a mere agreement between the parties. But res judicata always yields to considerations of public policy. In Mercoid Corporation v. Mid-Continent Investment Company, 320 US 661, 670, (1943). the Supreme Court said:

"But the patentees and licensees cannot secure aid from the court to bring such an event to pass, 'unless it is in accordance with policy to grant that help'***And the determination of the policy is not 'at the mercy' of the parties nor dependent on the usual rules governing the settlement of private litigation. 'Courts of equity may, and frequently do, go much farther both to give and withhold relief in furtherance of the public interest than they are accustomed to go when only private interests are involved.' ***'Where an important public interest would be prejudiced', the reasons for denying injunctive relief 'may be compelling.'". [Citations omitted]

The Mercoid decision was designed to protect the public against an illegal monopoly which underlies this dispute.

Considerations of public policy intended to finally end a dispute -- the basis of res judicata -- may be outweighed by countervailing of public policy considerations. In Agrashell, Inc. v. Bernard Sirotta Company, 281 F. Supp. 704, 708 (E.D.N.Y. 1968). the Court noted:

"Even res judicata in its strictest aspect yields where an issue deeply invested with public concerns is involved."

See also "Comment Note - Res Judicata as Subject to Exception When Its Application would be Opposed to Public Policy", 320 US at p. 680.

The conflict between res judicata and the public interest arose early in patent cases, appearing in Addressograph-Multigraph v. Cooper, 156 F. 2d 483 (2d Cir. 1946). In Addressograph-Multigraph this Court recognized the special circumstances attendant to consent decrees and noted that the doctrine of res judicata is limited by the public policy* against monopoly. The Court said at pg. 485:

"But, logic notwithstanding, it does not follow that to hold a patent invalid if it is not infringed, is also to decide a hypothetical case. The reason for this is the importance to the public generally that an invalid patent "should not remain in the art as a scarecrow." Then in Mercoind Corp. v. Mid-Continent Investment Co., 320 U.S. 661, 670, 64 S. Ct. 268, 88 L. Ed. 376, the Supreme Court held that in patent cases, as in other litigation, equitable relief should be either extended or limited as the public interest may require, and that as a result the doctrine of res judicata in patent cases is limited by the public policy against monopoly."

*Addressograph relied upon Cover v. Schwartz, 133 F. 2d 541, 545 (2d Cir. 1943) in which this Court identified one aspect of public interest:

"Indeed, since the public is affected, there is much to be said for a decision in such a case as to the invalidity of the alleged patent monopoly (either alone or in conjunction with a decision of non-infringement) whenever the issue of invalidity is before the court and the evidence warrants such a decision. For a decision as to invalidity will tend to discourage suits against others based on that patent, and mere threats of patent suits, due to the expense of defending such litigation, may often prevent lawful competition which will be in the public interest;"
[Emphasis added]

"On the basis of these cases, particularly Cover v. Schwartz and Electrical Fittings Corp. v. Thomas & Betts Co., supra, we would find no difficulty whatever in reaching the conclusion that the consent decree in the former suit would not operate to estop if non-infringement had been directly adjudicated herein. But even though we can only say that the consent decree left the issue of infringement without adjudication, nevertheless, we think on grounds of public policy we ought to rule that in a decree, at least in one entered by consent, either an adjudication of infringement, or a grant of some relief from which infringement may be inferred, is essential before any effect of *res judicata* can be given to it on the issue of validity. In other words, we think the public interest in a judicial determination of the invalidity of a worthless patent is great enough to warrant the conclusion that a defendant is not estopped by a decree of validity, at least when the decree was by consent, unless it is clear that in the litigation resulting in the decree the issue of validity was genuine."

In Addressograph-Multigraph, this Court only decided that a consent decree which merely decided validity did not estop a party from later contesting validity. Foreshadowing the problems involved in licensee estoppel and consent decrees, this Court compromised. It held that either an adjudication of infringement or a grant of relief was required. A distinction was drawn in that a holding of validity is a hypothetical matter whereas a holding of validity and infringement is an actual adjudication.* This compromise is questionable for reasons set forth in Judge Clark's dissent in Addressograph.

*There was more of an adjudication of validity in Addressograph than here where the decree expressly states that it may not be cited as an adjudication.

Judge Clark's view seems stronger in light of Sinclair and Blonder.

Since Sinclair, and given the breadth of the declaratory judgment, validity itself is an issue providing collateral estoppel (see also Blonder, 402 U.S. at 344). If the distinction in Addressograph remains as valid, then the problem resolves itself merely to correct draftsmanship to give a consent decree res judicata effect. A judge does nothing more than put his signature on a consent judgment; there is hardly an adjudication of anything whether it be validity or infringement. Such draftsmanship has no correlation with advancing any public policy.

As we see in this case, a license agreement requiring a consent judgment that only one product is infringing and a recitation of validity in such judgment is catapulted into a minimum-royalty, no contest, no termination license to which the Lear defense is emasculated.* The consent judgment becomes the vehicle for justifying otherwise illegal license provisions.

The impact of Lear does not in any way affect the holding of Addressograph, because the holding in Addressograph was merely that there was no estoppel. Thus, we do not seek to overrule Addressograph but to extend the application of Lear.

Addressograph does stand for the proposition that the public interest determines whether a consent decree is to be given full res judicata effect. Addressograph weakened consent decree estoppel

*We submit that when a license requires minimum royalties for the life of a patent, a non-termination clause, and a consent decree--all taken together--there is a misuse and allows the defense of validity to be raised.

when it was decided thirty years ago. It is ironic that it is now used as the leading case to strengthen consent decree estoppel.

We turn now to an analysis of the components of the public interest, referred to as the unruly horse by Judge Friendly.

POINT III

THE PARAMOUNT PUBLIC INTEREST
IS THE ADVANCEMENT OF THE
ARTS AND SCIENCES

Much of the character of the public policy has evolved from decisions of this circuit expressing open skepticism to the legitimacy of untested patents.

In Texas Co. v. Sinclair Refining Co., 87 F. 2d 690, 693 (2d Cir. 1937), (L. Hand, J.) it was stated:

"The patent seems to us another instance of a kind which must become more and more common as the arts advance in understanding and multiplication of detail, only a correlative of what had gone before, demanding no more than the competent use of knowledge already at hand. Courts have always discouraged efforts to dress up such advances which exploited by well organized selling, as inventions; that discouragement was never more proper than at the present time, at least while a patent law remains as archaic as it is." [Emphasis added]

Judge Hand's expressions have become patent classics. He referred to a patent as "a variant in vacuo", or a "scarecrow"; he made the "ant-like persistency of patent solicitors" as "leading inexorably to but one outcome", an unanswered criticism of ex parte patent procurement. Dugan v. Lear, Inc., 156 F. 2d 29, 32 (2 Cir. 1946); Bresnick v. United States Vitamin Corp., 139 F. 2d 239, 242 (2d Cir. 1943); Lyon v. Bob, 1 F. 2d 48, 50 (SDNY 1924).

The standards of patent validity recognized in this Circuit in 1955 as having become more exacting in recent years, Wright Way Engineering Co. v. Melard Manufacturing Corp., 219 F. 2d 329, 394

(2d Cir. 1955) (L. Hand, J.), are now established. It is now well recognized that the standard is severe, and, in short, patent office decisions rarely meet the Constitutional and Congressional patent standards (see Patent-Nonobvious Character, 23 ALR Fed. 326, 351-353), as well as the standards imposed by this Court. See Graham v. John Deere, 383 US 1 (1966), Koppers Company, Inc. v. S & S Corrugated Paper Machinery Co., Inc., ___ F. 2d ___, 185 USPQ 705 (2 Cir. 1975) and Zoomar Inc. v. Paillard Products Inc., 258 F.2d 527 (2d Cir. 1958).

Public policy is paramount and a patent "by its very nature is affected with public interest." Blonder, 402 U.S. at 343. See Sinclair Carroll Co., Inc. v. Interchemical Corp., 325 U.S. 327, 332, (where the Court required an adjudication of patent validity first since the purpose of the patent system is not one of reward, but to advance the arts and sciences.)

Yet the Patent Office is not effective in protecting the public interest against the issuance of invalid patents. The Supreme Court has repeatedly recognized the difference between the standards of the Patent Office in procurement and the standards of the federal court. In Graham v. John Deere of Kansas City, 383 U.S. 1 (1956) the Supreme Court said:

"We have observed a notorious difference between the standards applied by the Patent Office and by the Court."

Since Judge Hand's decisions, Courts in this circuit have recognized the ease with which patents are granted on non-inventions.

Lorenz v. F.W. Woolworth Co., 305 F. 2d 102, 105, fn. 6 (2d Cir. 1962).

One "flimsy" and "spurious" patent was held invalid by Judge Tenney as anticipated by Euclidian geometry. Ken Wire & Metal Prod. Inc.

v. Columbia Broadcasting Co., 338 F. Supp. 624,628 (S.D.N.Y. 1971).

By their very nature, weak and scarecrow type patents are frequent in litigation. Guide v. Desperak, 249 F.2d 145,148 (2d Cir. 1957).

Judge Dooling commenting on patent solicitation* observed:

"Now, what the courts are afraid of is that every time that happens, and you see this terrible imbalance of skill, the determined lawyer going back and back and back and back, rephrasing, dodging, punching, and he gets the examiner to feint at him, he slips the punch, and he comes through.

"And then there is that terrible gap at the end where the patent examiner said 'All claims are disallowed' and then the next document turns up. I'm very grateful for the courteous interview; all claims are allowed, including a few that nobody had talked about before."

Statistics quantify the feeling expressed in the foregoing cases. A great majority of patents are held invalid upon adjudication; the Second Circuit has held only 18% of the patents that have come before it as valid in the period 1961 to 1973 and from 1966 to 1973 the United States Court of Appeals have held 277 out of 403 patents invalid (see Tables 1, 2, 3 of Baum, "The Federal Courts and Patent Validity: An Analysis of the Record", Journal of the Patent Office Society, Vol. 56, pp. 760-762 (December

*Quoted in the APLA Bulletin of October-November 1970, at pp. 815-816.

1974) (copy attached)* . Many judges tend to lose faith in the patents issued. Some judges refuse to sign consent judgments.

The economic power of the strong is reflected in the success of patent procurement and litigation. They can carry heavy patent litigation expenses and infringers are motivated to "buy one's peace" as it is "often less troublesome." Ruben Condenser Co. v. Copeland Refrigeration Corporation, 85 F.2d 537 (2d Cir. 1936); Cleveland Trust Co. v. Osher & Reiss, Inc., 109 F.2d 917, 922 (2d Cir. 1940). Preuss v. G.E., 392 F. 2d 29, 36 (2 Cir. 1968).

Economic strength is obviously helpful in obtaining patents. Former Justice Fortas, commenting on the reasons for the difficulty that federal judges found in dealing with patent cases**, noted:

"Most judges, rightly or wrongly, are inclined to think that a strong, well-financed applicant has a pretty good chance of getting at least some patent claims allowed somewhere along the line, and they don't have much confidence in the process or respect for the result."

The Supreme Court has recognized financial burdens imposed in litigating a patent suit when a businessman is least able to defend one (Blonder, 402 U.S. at 334-336) and the "nuisance settlements" that are prevalent (Blonder, 402 U.S. at 342).

In Blonder, the Court referring to Senate testimony took note of

*Addendum A. See also, the tables in Dunner, et al, Patent Law Perspectives, "1971 Developments", pp. App. 38, 39 (copies annexed as Addendum B.)

**Journal of the Patent Office Society, Vol. 3, No. 12, December 1971, at p. 810.

nuisance settlements (402 US at 342):

"These nuisance settlements, although distasteful, are often, under the present system, justified on pure economics.

"In many instances the very survival of the small businessman may be at stake. His cost of fully litigating a claim against him can seriously impair his ability to stay in business."

Consent decree estoppel, as part of a nuisance settlement, is no minor matter. It is estimated that 72% of all patent cases between 1949 and 1958 were disposed of by consent. The disparity as to validity between the consent decree and the contested disposition on the merits is great. See "To Bind or Not to Bind: Bar and Merger Treatment of Consent Decrees in Patent Infringement Litigation", 74 Colum. L. Rev. 1322, 1330-1331, see also fn 60 (Nov. 1974).

The financially strong have an advantage in procuring patents, as well as forcing settlements. With the test of patent validity now established to be a severe one, and with licensee estoppel put to rest, and with settlement agreements having the same status as license agreements, the only artificiality left to protect an invalid patent is consent decree estoppel if permitted by the Court.

We submit that only patents which meet Constitutional and Congressional standards may be legitimate monopolies because of the nature of the public interest and the Constitutional mandate. Consent decrees do not allow for a different standard.

POINT IV

THE RATIONALE OF SCHLEGEL
IS INCONSISTENT WITH THE POLICY
OF LEAR AND BLONDER-TONGUE

Settlement Agreements Are Not Now
Given Final Adjudication Status

Schlegel emphasized the importance of settling patent suits. But once Lear established that a licensee could raise invalidity as a defense, it was applied to a settlement agreement which was considered in the nature of a license agreement and not a Court decree. Therefore, the decisions of Kraly, of Rialto, and of Massillon-Cleveland-Akron Sign Co., held that no estoppel existed at all in settlement agreements. The policy of promoting settlements in court litigation did not limit the overriding and broadening emphasis to be given to public policy in these cases. See Kraly, 319 F. Supp. at 1352.*

However, what difference is there between a settlement agreement and a court decree with respect to promoting settlements? We submit that as to this point, if settlements and the conserving of judicial resources are more important considerations than the public interest in the free flow and use of ideas and the removal of scarecrow and variant patents, there should be no difference in treatment between a consent decree and a settlement agreement. Both serve the same end. If one is good, so should the other.

*"No contest" provisions are impliedly disapproved in Kraly, expressly disapproved in Massillon, but impliedly approved by Judge Weinfeld based on the consent decree.

Sanctity of Decrees Is
Not The Main Issue

The main difference between a consent decree and a settlement agreement is the sanctity and integrity of a court judgment. We have recognized since this litigation began that a court judgment should not be entered if it could be disregarded or violated*. However, as a matter of overall policy, consent decrees should not be issued in patent cases or worded to make validity a finally adjudicated issue. Adjudication should result only from a judgment by a court on contested issues at the trial. In this way, the sanctity of a court decree would not come into question.

Judicial Involvement Should
Not Be The Test

In the Schlegel case, the court said that it was "not prepared to find that judicial involvement in a consent decree is so inconsequential as to justify different treatment [of the consent decree]". Judicial involvement may be presumed the moment a complaint is filed. But there was more judicial involvement in Addressograph than there was in either Schlegel or in this case.

*Wallace Clark is not violating a provision of any court decree for three reasons. First, it no longer makes the substance Meta-Tef 530 which is the only product identified in the consent decree and a Judge Weinfield recognized has the right to prove this at trial; secondly, it is licensed if there is any such infringement; and more importantly, there is no injunction provision in the decree.

Judicial involvement is not equivalent to an adjudication. An adjudication requires a judicial decision, whereas judicial involvement in a consent decree merely involves the court's acting upon stipulations presented by counsel. We submit that the Sixth Circuit comment as to judicial involvement is not the correct criteria for determining whether res judicata status should be granted.

Consent Decree Res Judicata
Does Not Require Early Patent
Attack

The Schlegel court recognized the public interest in stripping an invalid patent of its monopoly, but limited this policy in time so that it be performed as early a date as possible. The Court reasoned that this would force litigants to litigate the issue of validity. However, the court failed to recognize that settlement agreements do not have to end in a consent decree; and such settlement agreements allow the issue to be presented at a later date.

The Court also reasoned that the consent decree, if given res judicata status, would allow an infringer to forego attack until favored by a stronger financial position. Yet, this is the very problem to which Lear addressed itself. Licensees frequently take a license at a time when they are economically weak, just starting in the manufacture of a product, or starting a new business in the face of an entrenched patentee with more economic resources.

Licensees, as a class or individually, become stronger with the

passage of time and commercial success. The assumption is made in Lear that the economic incentive to challenge validity ripens with time. While Lear was premised on this assumption, it is expressly rejected in Schlegel. Further, the economic consequences resulting in higher consumer prices expressly noted in Blonder, 402 US at 346, were virtually ignored by the Schlegel court and the court below.*

Settlement agreements would be still frequent in patent litigation even, as we urge here, they lack the finality and certainty which true res judicata status achieves. After a first litigation, parties have a better understanding of the basic strength or weaknesses of a patent; there are sufficient practical deterrents to second patent litigations based upon the high cost today of patent suits and the time expended in litigation.

* "This has several economic consequences. First, the alleged infringer who cannot afford to defend may absorb the royalty costs in order to compete with other manufacturers who have secured holdings that the patent is invalid, cutting the profitability of his business and perhaps assuring that he will never be in a financial position to challenge the patent in court. On the other hand, the manufacturer who has secured a judicial holding that the patent is invalid may be able to increase his market share substantially, and he may do so without coming close to the price levels that would prevail in a competitive market. Because he is free of royalty payments, the manufacturer with a judgment against the patent may price his products higher than competitive levels absent the invalid patent, yet just below the levels set by those manufacturers who must pay royalties. Third, consumers will pay higher prices for goods covered by the invalid patent than would be true had the initial ruling of invalidity had at least the potential for broader effect. And even if the alleged infringer can escape royalty obligations under Lear when he is able to bear the cost of litigation, any royalty payments passed on to consumers are as a practical matter unrecoverable by those who in fact paid them."

In Blonder, the dual aspects of public policy involving finality of litigation and minimizing public or consumer economic disadvantages (such as pointed out in the footnote, page 24 supra) are coincident. Here these aspects are in conflict.

We submit that on close analysis, the rationale expressed in Schlegel and the Court below fail to give weight to the fact that of the vast majority of litigated patents 72% are settled by consent and that very few of these would stand up in court.* These "scarecrow" patents affect the public at large in terms of increasing prices and outweigh any burden imposed on litigants, and, we respectfully, submit upon the Courts.**

* In those cases where consent decree estoppel was not applied, the patents were held invalid. See Addressograph, Kraly, Crane. In Addressograph, the Court held the patent invalid with very little expense of judicial time, saying:

"This need not detain us long."

**The burden on the Courts today in criminal and civil right actions are almost infinitely greater than the burden imposed by patent litigations. One antitrust case of moderate size eats more judicial time than a multiple of patent cases. The same is true of a class action. We submit that any burden imposed on litigating patents otherwise the subject of consent decrees is not unreasonable. The burden today of criminal and other matters should not be a basis for minimizing the importance of Lear and Blonder-Tongue and the Constitution.

POINT V

CONSENT DECREE ESTOPPEL IS SUBJECT
TO THE SAME INFIRMITIES
AS LICENSEE ESTOPPEL

Judge Weinfeld stated that Wallace Clark had the right to raise issues of infringement but not validity. But a distinction between validity and infringement cannot be drawn so sharply because a determination of infringement involves matters as to the merits of the invention, which relate to validity.

Problems arise as to the scope of the invention. Are the claims to be read literally? May prior art be used to determine scope? Is the test of infringement one of equivalence with a prior infringing device or is the test the ordinary one of infringement? On this point, the Sixth Circuit, in Schlegel, could not find unanimity (see the dissent of Chief Judge Phillips.).

The same artificialities that had arisen in licensee estoppel will appear under the guise of claim interpretation. In Gat Gun Lubricating Corporation v. Adams Grease Corporation, 59 F. 2d 184, 186 (2d Cir. 1932) Judge Hand, commenting on the necessity of claim interpretation, stated:

"No doubt courts have wrenched the language of claims more than is necessary to include the defendant's "Gun" within the claim in suit. Were this a wide step forward - a "pioneer" patent - part of commanding originality, we might do so here. In such cases ordinary rules for the interpretation of written instruments fall in abeyance, however, judges may give them moot service."

And in Grubman Engineering and Manufacturing Co. v. Goldberger,
47 F. 2d 151, 153 (2d Cir. 1931) he said:

"The latitude we give does indeed depend how far the inventor has stepped forward; he may be a "pioneer". When he is we stretch his claims to the breaking point."

The language of the claim itself cannot be used alone as a basis of infringement. See Westinghouse v. Borden Power Brake Co., 170 U.S. 537 (1898); Thompson v. Westinghouse Electric and Manufacturing Co., 116 F. 2d 422, 425 (2d Cir. 1940); Pennington Engineering Co. v. House Engineering Corp., 136 F. 2d 210, 216 (2 Cir. 1943); and Linde Air Products Co. v. Morse Dry Dock and Repair Co., 246 Fed. 834, 838 (2 Cir. 1917). Patent claims may not be interpreted narrowly to avoid the prior art and then broadly for infringement purposes. White v. Dunbar, 119 U.S. 47, 51; Skirow v. Roberts Colonial House, Inc., 361 F. 2d 388, 391.

Lear recognized that the doctrine of contract estoppel was "radically" weakened by the introduction of prior art to limit claims. 395 U.S. at 665. In this circuit, prior art may be introduced for the same purpose, notwithstanding a consent decree. General Electric Co. v. Hygrade Sylvania Corp., 61 F. Supp. 476, 491-492 (SDNY 1944). Thus, the Lear incongruities and problems were put to rest with the abolition of licensee estoppel, only to rise again in consent decree estoppel.

In Lear, these incongruities were noted: 395 U.S. at 665

"Workable or not, the result proved to be an anomaly: if a patent had some novelty Formica permitted the old owner to defend an infringement action by showing that the invention's novel aspects did not extend to the inclusion the old owner's products; on the other hand, if a patent had no novelty at all, the old owner could not defend successfully since he would be obliged to launch the direct attack on the patent that Formica seemed to forbid. The incongruity of this position compelled at least one court of appeals to carry the reasoning of the Formica exception to its logical conclusion. In 1940 the Seventh Circuit held that a licensee could introduce evidence of the prior art to show that the licensor's claims were not novel at all and thus successfully defend an action for royalties. Casco Products Corp. v. Sinko Tool & Manufacturing Co., 116 F. 2d 119.

"In Scott Paper Co. v. Marcalus Manufacturing Co., 326 US 249, 90 L Ed 47, 66 S Ct 101 (1945), this Court adopted a position similar to the Seventh Circuit's undermining the basis of patent estoppel even more than Formica had done. In Scott, the original patent owner had attempted to defend an infringement suit brought by his assignee by proving that his product was a copy of an expired patent. The Court refused to permit the assignee to invoke an estoppel, finding that the policy of the patent laws would be frustrated if a manufacturer was required to pay for the use of information, which under the patent statutes, was the property of all."

It was this application of prior art which broke the slender reed of licensee estoppel.

If prior art is not used in determining claim scope, the remaining theories of infringement either require literal claim interpretation--an unacceptable test (see White, Skirow, Westinghouse, Thompson, Pennington and Linde Air, supra)--or equivalence to an

infringing structure. To date, this theory has been limited only to contempt actions, the patentee is given a greater monopoly than "he could obtain from the Patent Office." (Schlegel, dissenting opinion.)

The distinctions (1) between a consent judgment which determines validity but not infringement as opposed to one which determines validity and infringement, or (2) between a consent judgment which might be binding and a settlement agreement which may not be binding, or (3) between the use of prior art to show that the alleged infringement merely tracks what is old as opposed to the use of prior art against validity and the uncertainty as to the tests of infringement in license or contempt situations -- cannot be satisfactorily compromised.

These distinctions are subject to the same frailty as in Lear:

"The result has been a failure. Rather than create a compromise there has been a chaos of conflicting case law proceeding on inconsistent premises." See Lear v. Adkins, 395 U.S. 653 at 668.

The heart of the problem is that a Court does not make an adjudication on the merits. It acts upon the stipulations of counsel; the public interest in consent decrees is never examined with the scrutiny and intensity required in an adjudication applying the standards of §103 and Graham. In fact, the standards are not applied at all.

The monopoly becomes approved by the Court and is of the same far reaching consequences as any monopoly. In Blonder, the Supreme Court criticized these legal monopolies but which fail to meet these standards (402 US at 343):

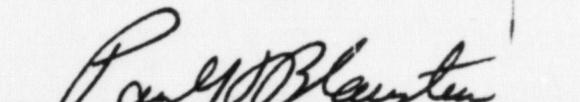
"Although recognizing the patent system's desirable stimulus to invention, we have also viewed the patent as a monopoly which, although sanctioned by law, has the economic consequences attending other monopolies. A patent yielding returns for a device that fails to meet the congressionally imposed criteria of patentability is anomalous."

CONCLUSION

In the final analysis, the public interest is based on the Constitution and the advancement of the arts and sciences. The elimination of those monopolies which create economic burdens on the population, as well as the free flow and use of ideas should outweigh the considerations identified in the Schlegel court and Judge Weinfeld below. The issue presented involves the same fundamental issues as Mercoid.

The intrinsic merit of a patent is still the best safeguard of the public interest in sanctioning monopolies on good patents, as well as the interest of the courts and litigating parties in rendering final decrees and ridding the docket of patent cases. This merit should not be shielded from judicial review.

November 1, 1975.


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entire period since 1920.⁶ Therefore, the statistics presented in this section are based on two separate records of decisions.⁷ The nature of these sources, along with other information regarding data collection and processing, is discussed in an Appendix to this paper.

Table 1. Findings on Patent Validity in U.S. Courts of Appeals, 1921-1973, by

| Years | Patents Valid | Patents Invalid | Total | % Valid |
|---------|------------------|--------------------|-------|------------|
| 1921-25 | 139 | 199 | 338 | 41% |
| 1926-30 | 218 | 219 | 437 | 50 |
| 1931-35 | 156 | 256 | 412 | 38 |
| 1936-40 | 171 | 368 | 539 | 32 |
| 1941-45 | 79 | 259 | 338 | 23 |
| 1946-50 | 56 | 140 | 196 | 26 |
| 1951-55 | 64 | 156 | 210 | 26 |
| 1956-60 | 79 | 158 | 228 | 31 |
| 1961-65 | 117 | 170 | 287 | 41 |
| 1966-73 | 126 | 277 | 403 | 31 |
| Total | 1180 | 2262 | 3352 | 35% |

Sources: 1921-60 data from *Official Gazette* of the U.S. Patent Office, 1961-73 data from *United States Patents Quarterly*.

Table 1 portrays the record of the courts of appeals on the issue of patent validity. The table indicates that the appellate courts have found more than half of all adjudicated patents invalid during every five-year period since 1920. Equally important, the proportion of invalidity findings has tended to increase over the fifty-year period. From 1921 to 1935, 43% of the patents adjudged were found valid. Since 1935, only 30% have been found valid.⁸ Annual data show that the trend toward invalidity findings was strongest in the period between the early 1930s and the early 1940s. There was a weaker trend in

⁶ **FEDERAL REPORTER** and **FEDERAL SUPPLEMENT**, of course, have published decisions of the federal courts for the entire period since 1920. However, the task of culling patent decisions from these comprehensive reports for a period of fifty years was impractical for the present study.

⁷ These are the record of decisions in the **OFFICIAL GAZETTE** of the Patent Office (1921-60) and in the **UNITED STATES PATENTS QUARTERLY** (1961-73).

⁸ Statistically the possibility that this decline resulted from chance rather than from a change in decisional tendency is considerably less than one in 1000, according to the chi-square test.

ADDENDUM A

the opposite direction between the mid-1950s and the mid-1960s, largely reversed since that time.

Table 2. Findings on Patent Validity in U.S. District Courts, 1921-1973, by Patents Adjudicated

| Years | Patents Valid | Patents Invalid | Total | % Valid |
|---------|---------------|-----------------|-------|---------|
| 1921-25 | 175 | 99 | 274 | 64% |
| 1926-30 | 214 | 136 | 350 | 61 |
| 1931-35 | 250 | 177 | 427 | 59 |
| 1936-40 | 225 | 293 | 518 | 43 |
| 1941-45 | 135 | 249 | 384 | 35 |
| 1946-50 | 98 | 105 | 203 | 48 |
| 1951-55 | 89 | 210 | 299 | 30 |
| 1956-60 | 104 | 192 | 296 | 35 |
| 1961-65 | 147 | 219 | 366 | 40 |
| 1966-73 | 211 | 338 | 549 | 28 |
| Total | 1648 | 2018 | 3666 | 45% |

Sources: 1921-60 data from *Official Gazette* of the U.S. Patent Office; 1961-73 data from *United States Patents Quarterly*.

Table 2 presents comparable data for the district courts. As the table indicates, district judges have been more likely to find patents valid than have their superiors. Even in the district courts, however, a majority of the patents adjudicated since 1920 have been declared invalid. Moreover, the same trend toward invalidity findings which occurred in the courts of appeals also took place in the district courts. In the published cases from 1921 through 1935, 61% of the patents adjudicated were found valid; since that time, the proportion has been only 39%.⁹ The proportion of validity findings decreased most rapidly during the period from the mid-1950s through the mid-1940s.

Decisional tendencies at both the trial and appellate levels vary considerably among judges and courts. This variation is suggested by the differences among circuits in the proportion of patents found valid, shown in Table 3. Moreover, the trends of decisions in some courts have not matched the general trends shown in Tables 1 and 2.

⁹ As with the courts of appeals, the possibility that the decline in proportion of patents found valid was due to chance is considerably less than one in 1000. See note 8, *supra*.

But most courts have shared a pattern of limited and decreasing willingness to find patents valid.¹⁰

Table 3. Proportion of Adjudicated Patents Held Valid, 1961-1965, by Circuit

| Circuit | Courts of Appeals | District Courts |
|---------|-------------------|-----------------|
| 1 | 26% | 32% |
| 2 | 18 | 22 |
| 3 | 20 | 18 |
| 4 | 26 | 36 |
| 5 | 46 | 57 |
| 6 | 42 | 34 |
| 7 | 49 | 52 |
| 8 | 11 | 27 |
| 9 | 26 | 46 |
| 10 | 50 | 53 |

Source: *United States Patents Quarterly*.

The decisional data presented in this section provide strong evidence that the lower federal courts as an aggregate have adopted more stringent standards of patentability since the 1930s. In both levels of courts, the proportion of patents found valid decreased dramatically in the years between 1930 and 1945, and that proportion has remained relatively low in the three decades since that time. This change in policy demands explanation.¹¹

¹⁰ The differences among courts in decisional tendencies on patent questions are most important, and they merit careful explanation. This paper will not be concerned with these differences; rather, it will attempt to explain the general pattern of decisions in the lower courts as an aggregate. A detailed discussion of recent differences among the courts of appeals on patent validity is contained in L. KAYTON, *supra* note 3.

¹¹ It might be posited that the courts did not change their policies; rather, the quality of adjudicated patents declined. One commentator has made an argument of this type. He suggests that the change in decisional tendencies resulted in part from the institution of declaratory judgment in the federal courts in 1925; this device allowed a non-patentee to bring suit over patents too weak for a patentee to entrust to court judgment. T. Cooch, *The Standard of Invention in the Courts*, in R. Calvert, *supra* note 1, at 49. However, the proportion of patent suits resulting from declaratory judgment actions, perhaps 10%, is too small to account for any major part of the change in decisional tendencies. For a fuller discussion of this point, see Baum, *supra* note 2, at 158-60.

Nor is there any other reason to believe that the quality of patents adjudicated has declined. Indeed, if the courts' standards have risen, as the preponderance of evidence indicates, the quality of patents

Court of Appeals Patent Validity Holdings as Reported in U.S.P.Q.

| Circuit No. | 1961-1965 | After the <i>Trilogy</i> & Before Anderson's- <i>Black Rock</i> ** | | After Anderson's- <i>Black Rock</i> *** |
|---------------------------|------------------------|--|--|---|
| | | After the <i>Trilogy</i> * 1966-1971 | After the <i>Trilogy</i> * 1972-1976 | |
| 1. | — | 33.3% (3/9) | 37.5% (3/8) | 0.0% (0/1) |
| 2. | — | 25.0% (7/28) | 26.0% (6/23) | 20.0% (1/5) |
| 3. | — | 26.4% (5/19) | 25.0% (4/16) | 33.3% (1/3) |
| 4. | — | 13.6% (3/22) | 16.6% (3/18) | 0.0% (0/4) |
| 5. | — | 35.0% (16/35) | 23.0% (5/21) | 53.3% (8/15) |
| 6. | — | 77.8% (10/21) | 41.6% (5/12) | 55.5% (5/9) |
| 7. | — | 36.1% (58/176) | 50.0% (50/50) | 29.4% (5/17) |
| 8. | — | 0.0% (0/18) | 0.0% (0/17) | 0.0% (0/1) |
| 9. | — | 15.0% (8/53) | 19.0% (8/22) | 0.0% (0/11) |
| 10. | — | 14.3% (1/7) | 20.0% (1/5) | 0.0% (0/2) |
| D.C. | — | 16.7% (1/6) | 33.3% (1/3) | 0.0% (0/3) |
| <i>Total and Averages</i> | <i>38.4%</i> (121/315) | <i>30.3%</i> (89/294) | <i>30.9%</i> (69/223) | <i>28.2%</i> (20/71) |

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ADDENDUM B

PATENT RESOURCES GROUP

Washington, D.C.

April 10, 1971

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 Kayten *The Crisis of Law in Patents*
 Patent Resources Group 1970 as up-
 dated to U.S.P.Q. of March 8, 1971.

Court of Appeals Patent Validity and Infringement Holdings as Reported in U. S. P. Q.
(After Trilogy and Up To and Including U.S.P.Q. of March 8, 1970)

| Circuit No. | Valid | Valid but Infringement | | Valid and Infringed | Valid but No Yet Decided |
|--------------------------|----------------|---------------------------|--------------|------------------------|--------------------------------|
| | | Not Yet Decided | Decided | | |
| 1. | 35.5% (3/9) | 11.1% (1/9) | — | — | — |
| 2. | 25.0% (7/28) | 17.9% (5/28) | 17.6% (3/18) | — | — |
| 3. | 26.4% (5/19) | 5.3% (1/19) | — | — | — |
| 4. | 13.6% (3/22) | 9.1% (2/22) | — | — | — |
| 5. | 45.9% (16/35) | 37.2% (13/35) | 4.8% (1/21) | — | — |
| 6. | 47.8% (10/21) | 28.6% (6/21) | 2.9% (2/68) | — | — |
| 7. | 46.1% (35/76) | 34.1% (26/76) | — | — | — |
| 8. | 00.0% (0/18) | 00.0% (0/18) | — | — | — |
| 9. | 15.0% (8/53) | 5.7% (3/53) | — | — | — |
| 10. | 14.3% (1/7) | 14.3% (1/7) | — | — | — |
| D.C. | 16.7% (1/6) | 16.6% (1/6) | — | — | — |
| <i>Total and Average</i> | 30.3% (89/294) | 20.0% (59/294) | 2.0% (6/294) | | |

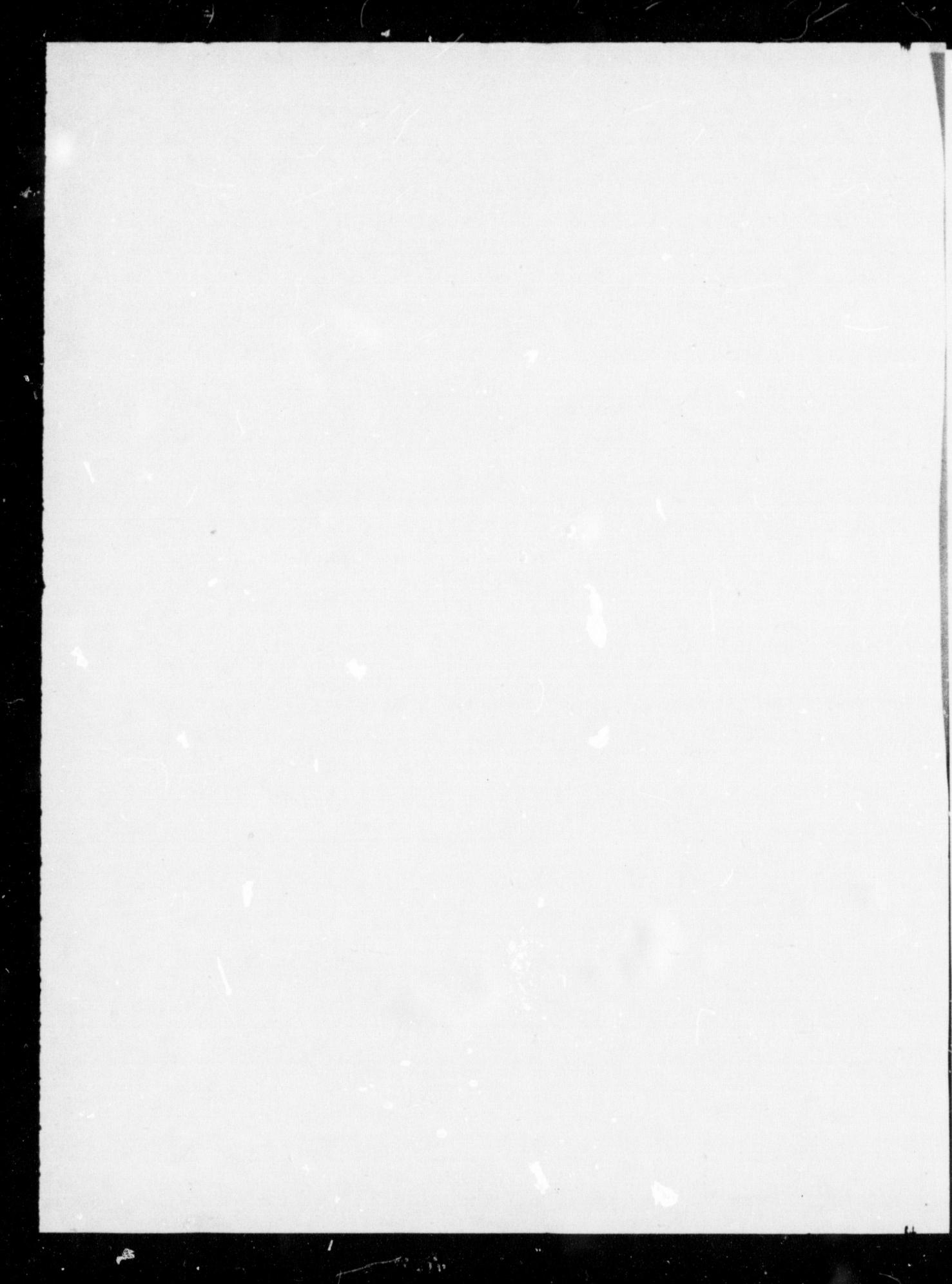
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(Rel. No. 9 / August 1971) (PLP)

PATENT RESOURCE GROUP
 Washington, D.C.
 April 16, 1971

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 March 8, 1971.

App. 2



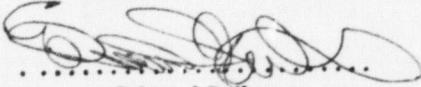
Wallace V. Acheson - Blawster

AFFIDAVIT OF PERSONAL SERVICE

STATE OF NEW YORK,
COUNTY OF RICHMOND ss.:

EDWARD BAILEY being duly sworn, deposes and says, that deponent is not a party to the action, is over 18 years of age and resides at 286 Richmond Avenue, Staten Island, N.Y. 10302. That on the 3 day of Nov 1975 at No. 330 Madison Ave, N.Y. deponent served the within *Bruel + Goldstein* upon *Connie + Goldstein* the *Appellee* herein, by delivering a true copy thereof to *h* personally. Deponent knew the person so served to be the person mentioned and described in said papers as the *Appellee* therein.

Sworn to before me,
this 3 day of Nov 1975


Edward Bailey

William Bailey
WILLIAM BAILEY
Notary Public, State of New York
No. 43-0182945
Qualified in Richmond County
Commission Expires March 30, 1976